Volume XVI

AUGUST 15
1947

Number 36

As I see

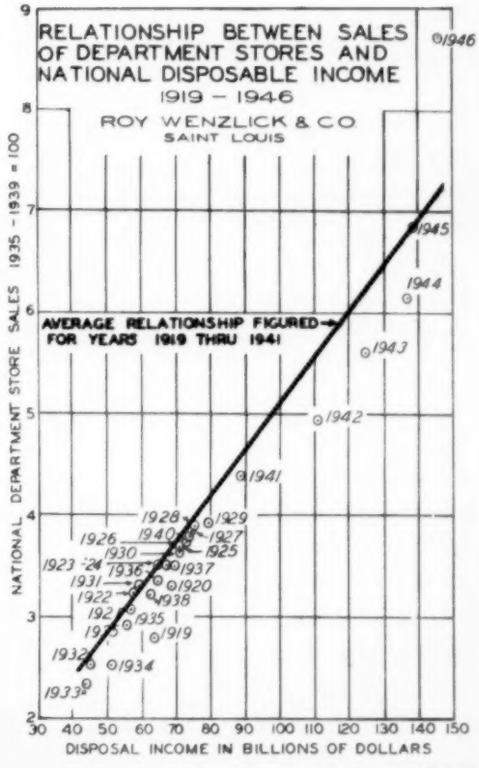
THE FUTURE OF RETAIL STORE PROPERTIES

IN the last few months we have had many store owners and many large retailers ask us about the future of retail store rents, both in the central business district and in outlying areas. In trying to answer these questions it might be well first to review the general principles that determine the dollar rents of retail shops. If we understand why these rents go up and down, we have a better basis for determining the proper level and probable future trends.

The rent of any retail location over the long period will depend largely on the most profitable volume of business which can be done on that location by the most enterprising merchant able to use it most intensively.

Every piece of real estate has a "best and most profitable" use, the use which can afford to pay the highest rent. The interest of the landlord and of the tenant alike tends toward the use of each piece of property for its best and most profitable use. A property which is not so used cannot afford to pay adequate rent to the landlord for the location. A tenant in a location more suitable for some other line of business will find that persons in the more suitable line can outbid him in the rent they can afford to pay.

The volume of retail business that can be done in any location depends, in addition to the factors which control the general market, on the accessibility of the location in question to its potential customers. Therefore, value and rents will vary with the accessibility to the potential customers for the best and most profitable use. Accessibility is influenced by location in reference to mass transportation, individual transportation with adequate parking facilities, contiguous population and habit.



The principal of the general market factors which influence all retail rents is the variations from year to year in disposable income in the supporting community available for the type of merchandise sold on the location. It has been found that a definite relationship exists between the amount of disposable income and the amount spent for various commodities, and that when this relationship has been determined it re-

mains fairly constant providing that the items desired are available for purchase.

The chart at the bottom of page 295 shows the relationship of disposable income in the United States to department store sales from 1919 through 1946. The scale on the left of the chart shows department store sales in billions of dollars. The scale along the bottom of the chart shows the disposable income of the people of the United States also in billions of dollars. Each dot on the chart represents the relationship in the given year between department store sales read on the left-hand scale and disposable income read on the scale along the bottom of the chart. For example, in 1946 it will be seen by the position of the dot that department store sales ran approximately $8.7 billion and that disposable income ran approximately $146 billion. In contrast, in 1933 department store sales ran approximately $2.3 billion and disposable income ran $44.5 billion. The heavy line on the chart represents the average relationship of department store sales to disposable income. From this line the volume of department store sales can be estimated roughly in the future if it is possible to estimate what the disposable income may be.

The fact that all of the dots do not fall exactly on the line shows that the relationship between department store sales and disposable income is not absolutely mathematical, but it is quite surprising that in normal years the relationship has been as close as shown here. During some of the war years merchandise, particularly of a durable goods type, was unobtainable and during this period sales did not equal the amount which had been expected from the amount of disposable income. This is clearly apparent in that during these years a number of the dots are considerably below the heavy diagonal line.

Mass transportation originally kept the downtown sections of our principal cities accessible to the constantly widening areas of residential development. The 100 per cent districts (the retail shopping locations able to pay the highest rents) developed in areas within easy walking distance of stops for trolleys, buses, or other types of mass transportation.

There has been a pronounced tendency, however, for the best downtown retail locations in any city to creep in the direction of the center of purchasing power in the residential districts. By "center of purchasing power" is meant the area in which population times disposable income is greatest. The retail downtown district of every city is on the move, although most of them are moving quite slowly at the present time. The widespread use of individual transportation in the automobile has accentuated this movement.

The reason for the movement toward residential districts is more or less self-evident. When new locations are needed in the central shopping district, retailers naturally prefer locations between their competitors and the stream of incoming traffic. In this way the value of the new location is enhanced by the persons en route to their competitors. To locate new retail stores on the other edge of the existing downtown district would necessitate a tremendous amount of advertising to pull the traffic beyond its accustomed stopping point. In time the establishment of numerous new stores on the incoming fringe of the downtown district takes sufficient volume from those on the opposite edge of the district to destroy a large part of their values and the best district gradually creeps toward

the incoming traffic.

For fifteen years I have made it a practice in the various cities I have visited to inquire from the older real estate men the direction of movement in the past of the best retail districts in their cities. In more than 100 cities I have found no exception to the general principles as stated above.

Within recent years the automobile has contributed to the development of some major outlying shopping centers. In many cities these centers are developing retail rental values of the land almost equal to those of the downtown business districts. Before the great multiplication of the automobile, the largest mass buying centers always developed in areas inhabited by persons whose places of employment were not in the downtown districts of the city. In more recent years, however, many major subcenters have started developing in areas occupied by downtown office workers.

The development of super food markets in some subcenters is not really a movement from the downtown shopping district, as in most cities of over 100,000 people relatively little food has ever been sold in the downtown shopping area.

Vehicular traffic passing a retail location adds little to its value other than the value of advertising. The widening of Michigan Boulevard in Chicago, making it a major traffic artery into the Loop, increased land values in the Loop and at the far end, but values in the intermediate blocks of the boulevard did not increase because of the widening. Traffic increases land value only as it makes the site more accessible to potential customers. The occupant of a vehicle rarely purchases anything except a newspaper, gasoline, oil, or refreshments. He must become a pedestrian before he contributes greatly to retail land value. If he is traveling in a mass transportation vehicle, the transition to a pedestrian is relatively easy. He merely leaves the bus or streetcar at the nearest corner and walks to the store. If, however, he is driving his own car the problem is greatly complicated in most cases by the lack of adequate parking facilities close enough to the destination to be acceptable to the shopper.

In many cities the zoning ordinances now require that off-street parking facilities be available before the permit can be issued for types of use which would otherwise cause traffic congestion. It seems probable that in the future more emphasis still will be placed on the necessity of proper terminal facilities for the automobile shopper. In subcenter developments it requires more parking space in relationship to sales area than it does in the downtown district, because a smaller percentage of the shoppers use mass transportation. In the average subcenter parking space should be available varying from one square foot of parking area for each square foot of sales area to a maximum of three square feet of parking space for each square foot of sales area. The three-to-one ratio would prevail for stores in which the shopping period is quite long; the one-to-one ratio could be used in areas where the shopping period is quite short. Probably the best average ratio for a subcenter is a parking area twice the area of the sales space. Roughly, it should be figured that an automobile parked by the occupant requires from 235 to 270 square feet of space, with the larger figure recommended, including entrance and exit lanes. If cars are parked by an attendant, parking space per car can be reduced to as little as 150 square feet, but this requires

constant shifting of the cars on the area.

Transfer corners for mass transportation frequently develop high values because of their accessibility to large numbers of potential customers. Large amounts of money have been lost, however, through the assumption that these potential customers added considerable value to locations only slightly removed from the point at which the transfer is made.

The second great factor contributing to accessibility of retail sites, and therefore to their rents and values, is vertical transportation in the form of high-speed elevators and escalators. This contribution has been two-fold. It has made possible the daytime population of constricted business districts sufficient to furnish potential customers in large numbers, and it has made possible the multiplication of the area of the best shopping locations by the addition of extra floors of shopping space. A department store occupying a single block in the most desirable location in the downtown district may contain ten or more blocks of shopping area. An office building may contain a daytime population larger than a small city with many wants that can be satisfied during the noon hour and at other times during the day. The concentration of land use, however, due to multi-story buildings has greatly complicated the present problems of the modern downtown district. It has been estimated that if all persons working and shopping in the downtown district entered the district in private automobiles and that if all buildings were only one story in height, three-fourths of the area would still have to remain vacant in order to provide parking space for the automobiles. Fortunately, a large percentage of the persons in the downtown district of any city come and go by means of mass transportation.

The third great factor contributing to accessibility is habit. The habit of a majority of people to walk on the shady side of the street in a southern city may make the retail sites on the shady side more accessible than those on the sunny side. The difference in normal site value of the two sides of the street for retail stores in this case would be equal to the increased cost (generally of advertising) necessary to bring the same number of potential customers across the street. In this case the advertising expense is substituted for land rent.

If the difference in site value were more than the advertising expense, then the best location would be on the sunny side of the street, as the cost of developing a unit of sales would be less by paying the lower ground rent and the higher advertising expense. If the difference in site value were less than the advertising expense, then the demand for the shady side location would increase until the difference was equal to the difference in cost of developing the same intensity of accessibility.

If the cost of drawing customers across the street in this illustration is too great, it may result in a very low land value on the sunny side of the street for retail use. If some other use could pay a higher rent, this other use would prevail and the rent it could pay would be the economic rent for these locations.

The measure of the accessibility of a retail site is the quality and quantity of the pedestrian traffic passing it. This includes those who have entered the district in mass transportation and those who have come in their own automobiles

and found parking facilities in the neighborhood. It was at first assumed that quantity only of pedestrian traffic could be used as a measure and many retail stores located as a result of quantitative traffic counts discovered that quantity alone is a poor guide of potential sales volume.

A store may be of a type where it is highly accessible to those entering the district by mass transportation but inaccessible in its appeal to vehicular traffic either due to the location some distance from major highways or due to the lack of parking space around the store.

One other factor which should be mentioned in connection with retail locations is that similar use increases value and dissimilar use decreases value. A block in which the appeal of each store is to the same type of shopper will have a far higher value than a block in which the appeal is quite varied.

It is self-evident that retail store rents in the long period consist of two totally different payments, a payment for the use of the building and a payment for the rent of the land. The payment for the use of the building should include adequate depreciation allowance, maintenance, interest on the investment and taxes on the building. The rent of the site should include interest on the present cost of the replacement of its share of streets, utilities and other improvements to the site and to its influencing environment, together with the land taxes on this part of the value of the land. The residue of the rent of the site is pure economic rent.

The economic rent of a retail site in a city will be the difference in the profit possibilities of using it in place of a site where possibilities of sales would be only sufficient to repay the capital and labor expended in developing them. Each retailer on any site will attempt to maximize the sales in his location by expending capital and labor until the last unit yields no profit. On the best location this will probably result in a many-story building which will increase the economic land rent to the landlord. The retailer in the best location will also find that advertising will increase his net and so he will increase his advertisements until the cost of the last unit of advertising will just pay for itself. This again will increase the rent of the site in the long run period as it will increase the differential between this site and the amount that could be made on the poorest site that could be used.

Some people assume that the best sites are best because the retailers using them spend tremendous amounts in advertising to bring customers to their stores. This is confusing cause and effect. Only the best sites can afford to advertise as they only are readily accessible to the potential customers who will read the advertisements. Unless a store has a city-wide appeal and is easily accessible to the entire city, a large part of the advertising that it could do in any mass medium would be wasted. Its advertising cost per unit of sale would be too high and it would eventually be forced either to restrict the amount of advertising it could do or to seek a better location.

This is exactly the same principle involved in the application of additional units of capital and labor to agricultural ground. The additional capital and labor is applied in the largest amounts to the best ground, not to the poorest. It is a fact that the best ground pays the highest rent, which makes necessary its inten-

sive cultivation.

Theoretically, rents will tend to rise on any location in the long-run period until they will equal the differential advantage of that location when used most intensively. Actually, because of long-term leases and other rigidities in our economy, there may be periods of considerable length when the site rent paid will not be equivalent to the economic rent.

But how about the site rent of an outlying location such as those frequently chosen by Sears, Roebuck & Company? Is the value of the ground increased by such a use above its value if used by the small retailer? Does mass medium advertising here create an additional ground rent? Over the long period it probably does as over the long period it probably will change shopping habits and will build up a subcenter around the isolated store. Until such a subcenter develops, however, the ground rent has not been increased as innumerable sites could have been used with equal advantage. Advertising has been substituted for rent and will be increased until the last unit of advertising merely brings in enough additional business to pay for its cost without increasing the profit of the concern. If the site itself has no differential advantage in comparison with other sites readily available in large numbers, the expenditures of large amounts in advertising may pay a return on the enterprise of conducting a business, but, except as noted above in the long-run period, it will not increase the economic rent of the site.

While theoretically over the long period rents will tend to approach the differential advantage of the location, the actual contract rent is arrived at through the "higgling" of the market and is the result of the inter-reaction of the desires of the tenant and the landlord.

What a tenant can afford to pay for a retail site is determined by the utility of the site to him. If its value to some other prospective tenant is greater, it would be to the interest of both the landlord and the tenant to rent to the latter. The landlord will be satisfied only by the best and most profitable use of his site and only the prospective tenant with the greatest use for the site can afford to compete for the rental. Only a very few blocks in any large city have a very high degree of accessibility to potential customers. More retailers prefer to be in those blocks than those blocks will accommodate. The rentals in the best blocks, however, in the long-run period will tend to approach the value to those tenants who can use the locations most intensively. If a retailer through error in judgment and eagerness to be in what is considered the best block agrees to pay an amount above its value to him, his business will not be profitable and in the long period he will probably be replaced by a more logical tenant.

In attempting to make a lease a tenant will attempt to lease the best location for his business at the lowest net cost to him. This will involve many factors:

1. Each location is unique, different in some aspects from every other location. The complete analysis of the pedestrian traffic passing a given location, were such an analysis possible, would reveal vast differences in the number of persons, in their wants and in their ability to satisfy these wants in comparison with the persons passing other locations. There would be a high degree of similarity, however, from day to day and from year to year on the same site. If this

relative consistency were lacking, the successful location of retail shops would be accidental. The tenant will attempt to rent the space available at the time which in his opinion is accessible to the largest number of potential customers for his goods.

2. The tenant will attempt to contract a lease for the length of time most favorable to him. He will take into consideration the gradual shifts in the retail districts which will make a location either better or worse in the future. He will also take into consideration the amount of the vacant space available, the position in the business cycle and many other factors which in his opinion will make either a long or a short lease best for him. It would be to his advantage to have a lease expire at the bottom of a depression, as under those conditions he could secure a renewal of the lease at a lower price than if it were to run out in a period when business activity was increasing.

3. The tenant will attempt to make either a lease for a fixed amount or one for a percentage of his gross business, depending on which he thinks will work out best for him. On a percentage lease he may get a lower rental during the early part of the lease with a higher rental as he develops his business. In percentage leases made prior to and during World War II price inflation has increased the rent considerably. Even though he still sells the same number of units, since these units now bring a higher dollar price the rent has increased by the same percentage. If he does not think the percentage lease will work out to his advantage, he may offer the landlord a lease in which the rent increases by specific amounts and at stated intervals. This was fairly safe during a rising market, but should be done with great caution in 1947. The tenant may find it to his advantage to insist on a renewal clause in his lease which will specify the conditions under which the lease can be renewed for a second or third period.

4. The tenant will attempt to rent space which in size and arrangement will lend itself most efficiently to his use. For some purposes a long frontage, shallow in depth, is more desirable; for others, the more usual proportions are better.

5. The tenant will attempt to get the most attractive store front and window display space if his business requires it, and he may attempt to get the landlord to make extensive alterations to fit the space to his use.

In all of the foregoing, the tenant will attempt to estimate the value to him of all the various elements which make up the different sites available, together with the terms under which they can be rented He will decide on that space in which in his opinion he can develop the largest volume of business at the lowest cost. His estimates will quite frequently be incorrect, as they were in 1929; but, right or wrong, they will have their effect in determining the level of the market.

Many tenants at the present time are over-estimating the volume of business which they can do during the period of a long-term lease. The chart on page 295 clearly shows that in department store sales in 1946 the dollar volume is running higher than it should considering the disposable income of the United States. This period will probably be followed by a period in which sales will snap back to their old relationship.

SUMMARY AND CONCLUSIONS

- Disposable income is certainly at or near the peak.

- Retail sales follow disposable income in a normal market. The market is at present abnormal. When it returns to normal, retail sales will drop.

- Durable goods (washing machines, refrigerators, radios, etc.) were largely unobtainable during the war. Because of the accrued demand which built up during this period, the sales of these items have been greater in the recent past than would have been expected from disposable income. When this accrued demand has been satisfied, recurring demand will be at a lower level and sales will probably snap back to the old relationship to disposable income and many stores will pass out. The best credit risks in tenants during the next few years will be those in consumer goods lines such as food, clothing, etc.

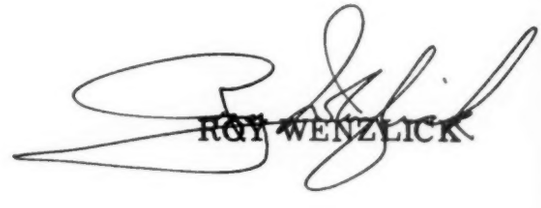
- All downtown districts are creeping gradually toward incoming traffic entering the downtown districts from residential districts. This movement is quite slow but will continue.

- The biggest current problem of downtown districts is traffic congestion and off-street parking. There is no complete solution to this problem and it will continue to be a decentralizing influence. The downtown district, however, will continue to be the major shopping district in any metropolitan area.

- Beware of outlying shopping developments with inadequate off-street parking. There should be at least two square feet of parking area for each square foot of sales space. Often a new shopping area will appear to have adequate parking space merely because it is only partially built up.

- Leases from the tenant's standpoint should be of such length that they will expire during depression years, as then they can be renewed on a more favorable basis. From the landlord's standpoint an expiration date during boom periods is desirable, as these leases can probably be renewed on a more favorable basis to him.

- If the general price level falls, all other factors remaining the same, dollar rents of retail shops will fall. If the general price level should rise still further (believed very doubtful), retail rents will advance.



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